SACU
San Antonio Federal Credit Union

6061 IH-10 West
Post Office Box 1356
San Antonio,Texas 78295-1356
www.sacu.com
210/258-1414

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Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

I understand the NCUA has drafted proposed regulation directed at regulating the corporate credit union network. While written with the intent of strengthening the corporate network through regulation meant to minimize risk, it is paramount we realize that this is not regulation for the corporate credit union's but rather regulation for natural person credit unions as well. The events leading to the collapse of financial markets and ultimately to the current state of our corporate credit union network have been felt by our entire nation. The losses the corporate credit unions are experiencing in their investment portfolios are no different in scope or severity than those in the banking or Federal Home Loan Bank system. Very few economists' predicted the magnitude of market stress that has occurred. I can't blame the corporate network for the current situation, especially as they were operating under the constant and direct supervision of the NCUA throughout this period.

While I can sympathize with the NCUA's wish to ensure "this never happens again", I feel the agency should refrain from regulating from the standpoint of a five hundred year flood mentality – although such an event is always possible, each flood season brings the same chance – 1 in 500. In reviewing the proposed regulation, I use the analogy of a surgeon and how he uses a scalpel instead of a chainsaw to remove unviable tissue. This regulation, in its' heavy handed approach, has the potential to not only kill the patient (the corporate credit union's) but the family as well (natural person credit unions) in that the regulation will have unintended and long reaching consequences to natural person credit union business models. The NCUA must provide a solution that strikes the balance between "too big to fail" and "too regulated to succeed". The agency has stated *"we'll dictate the safety and soundness conditions to protect the system; you, natural persons, decide if you want a corporate system."* The revision of this rule must be strategic, considering the near term and long reaching consequences of its terms. I urge the agency to consider all alternatives to strengthen the corporate credit union system and our industry as a whole. Perhaps going back to some of the tried and true basics such as down payment requirements and prepayment penalties could do much to strengthen the system.

The first issue I would like to address is with respect to interest rate risk. Natural person credit unions have increased their holdings of residential loans in recent years. We can debate the reason for this, whether it be reaching out longer on the curve for margin and/or responding to our member demand. The fact is natural person credit unions are holding larger concentrations of these assets and must be afforded tools to mitigate the risk currently on their balance sheets. Section 704.8 of the proposal limits the weighted average life of a corporate credit union's investment portfolio to two years. Although not stated in the language of the rule, the NCUA has stated that the investment portfolio must include member loans. The use of long-term borrowings is an effective tool to reduce interest rate risk and while we certainly understand the concept of WAL, this limit would reduce a corporates' ability to offer term funding to members in order to ensure they meet the two year limit. The NCUA feels that most members' do not borrow term; however those that do would be adversely affected by this change. Given the required collateral requirements and haircuts, I feel member loans should be excluded from the WAL test. I also question the ability of a corporate to generate enough interest income with such a short portfolio life. I would recommend a longer weighted average life of three years and that agency and government-guaranteed securities be treated separately with a longer weighted average life restriction of five years. Finally, to critics that may feel natural person credit unions should just stay out of the residential lending space and only offer short term loans (less than seven years, for example) – we must really consider the effects of such on our members. Natural person credit unions have responded to member demand in terms of the products and services they offer - would shifting that demand to the banking sector be what is ultimately best for our member?

Section 704.8(e) appears to be a knee jerk reaction to recent events and the resulting freezing of credit markets. The proposed spread widening of 300 basis points coupled with a NEV decline limit of 15% is too restrictive. I would argue that there is no combination of assets with a two year average life that could generate sufficient margin to attract funding and pass a 300 bps credit shock test. Excluding recent events, credit spreads to LIBOR have widened to a maximum of about 50 bps – it would seem more plausible to set the credit shock test at 100 bps widening or double the historical average. 300 bps is six times the historical average! Additionally, we should use a lower credit spread shock for securities issued by GSE's as these trade in very large and liquid markets. Furthermore, section 2 rules that derivatives are to be excluded from the shock test even though these are clearly not immune from the impact of credit spread widening. Part III (derivatives expanded authority) specifically allows credit derivatives, which are used to mitigate the very risk being tested. It is absolutely inconsistent to allow derivatives that hedge credit spread widening yet disallow those instruments from a credit shock widening test. Part III also speaks to counterparty credit ratings, stating that counterparty credit rating be no lower than the minimum permissible rating for comparable term investments. Derivatives are executed with major commercial or investment banks. Holding derivatives to the same standards as investments would restrict a corporate from executing derivatives due to a lack of counterparties as there is currently just one counterparty that has a rating of AA- or better. This change would not only limit a corporate credit union from using derivatives to manage interest rate risk, but would also limit their ability to issue structure products such as floating or amortizing certificates. In turn, corporate credit unions would not be able to provide a hedge program to member credit unions. We suggest the NCUA exclude derivatives from the investment credit ratings and concentration limits. Master ISDA agreements are in place with each derivative counterparty, allowing for netting of exposures and requiring collateralization of mark-to-market exposures beyond a predetermined threshold. Perhaps a separate limit of capital could be imposed as the maximum threshold exposure amount allowed to be negotiated in Master ISDA agreements with counterparties. Natural person credit unions should be very concerned of the impact these proposed controls would have on their own financial performance.

Proposed changes to 704.8 limits a corporate credit union's ability to pay a market based premium on early withdrawals. By removing the comparable liquidity option, all corporate certificates would be at a distinct disadvantage. As is evident in the longer term issuance of broker certificates as in the SimpliCD market space, member credit unions wish to utilize share certificates as an investment option. While I feel this proposal is an attempt to ensure system liquidity, it will have the opposite effect as well as prevent the emergence of a sound funding strategy for all corporates.

Regarding re-capitalization, NCUA's guideline was to assume a corporate balance sheet that does not include legacy assets. NPCU's need to be assured that new capitalization dollars would not be subject to additional losses from these legacy assets. The proposal sets new capital standards along with targets for reaching the various levels over a ten year time frame. These targets and time frames are unrealistic given the proposed balance sheet structure. If the corporate takes enough risk to meet the capital requirements, they won't meet the stress test. If they manage to meet the stress test, they won't be able to generate enough income to meet the new capital requirements within the proposed time frame. If corporates' are unable to generate income on their margins, fees charged to NPCU's would have to increase, ultimately pushing this cost down to the member.

I urge the agency to consider the long-term consequences of the proposed regulation. Our industry is vertically integrated and steps that limit options for the corporate credit unions will in turn limit options for natural person credit unions. Diversification is the key to the sustainability of any business model. The NCUA stated in their town hall meeting that there would not be twenty-eight corporate credit unions in the future "it is far too many for what is needed". We have a concern that in the event there is a reduction in the number of large corporate credit unions, this would limit those remaining corporates from being able to meet the needs of the large NPCU's. Although different than the needs of smaller credit unions, the needs of large NPCU's are just as significant. In the event that there need to be fewer corporate credit unions, we would recommend that the remaining be of significant size and expertise to meet the needs of the larger NPCU's. Overall, I would recommend any changes to the regulation be written in such a manner to have the flexibility to accommodate unforeseen circumstances. This could be accomplished through an appeals process that is defined by the agency within the change to the regulation. Our members, perhaps now more than ever, are relying on us to provide them with the best options to meet their financial needs. We must ask ourselves if we believe in the credit union model. Since their inception, credit unions have stressed "the credit union difference", not-for-profit cooperatives, owned and directed by their members. Their mission is to provide a safe place for members to save and borrow at reasonable rates. I sincerely believe the regulation of the corporate network to the point they are no longer a viable option for natural person credit unions would have a significant negative impact to natural person credit unions – ultimately the member will lose.

The NCUA has been charged to strengthen the wholesale corporate system. They must do so by providing a solution that allows corporate credit unions to take an appropriate level of compensated risk necessary to build retained earnings as well as provide products and services necessary to serve credit unions. Unlike a bank, a credit union must generate capital through earnings, the excess of which is passed on to its' members – also unlike a bank. I urge the agency to be mindful of the old saying *"with no risk comes no reward"* – offering a solution that attempts to remove all risk is perhaps the most risky solution of all.

Sincerely,

Jeffrey H. Farver

Jeffrey H. Farver
President and CEO
San Antonio Federal Credit Union